Loyalty Rebates

Barry Nalebuff

Milton Steinbach Professor
Yale SOM
barry.nalebuff@yale.edu

No One Theory

Are products in bundle   substitutes (branded and generic tape)

complements (engines and avionics)

used in fixed proportions (nail cartridge and nail)

one-way essential (windows and media player)

ex ante complements & ex post substitutes (Aspen)

neither (different blood tests, medical devices)

positive correlation in value or negative correlation

Is demand   exogenous and inelastic (dialysis fluids)

variable (lawn mower engines)

Do full-line rivals exist

MOTIVATIONS AND EFFECTS OF BUNDLING DIFFER ACROSS THESE CASES

NOT LOST IN THE DESERT. CAN USE SAME TOOLS TO ANALYZE EFFECT ON COMPETITION

Ten Propositions

#1 Hard to Justify Negative Prices

#2 Loyalty Discounts Can Create No-Cost Predation

#3 Exclusionary Bundling Test is Practical Detection Device

#4 Lump-Sum Rebates are Less Competitive

#5 Loyalty Rebates Make Pricing Opaque

#6 A's Price to Customer Shouldn't Depend on Who Else Customer Buys From

#7 Beware Bogus Bundle Discount Justifications

#8 Yes Virginia, Bundling Can Leverage (and Protect) Market Power

#9 Chicago School Story is Correct Under Strong Assumptions But Misses Interesting Cases

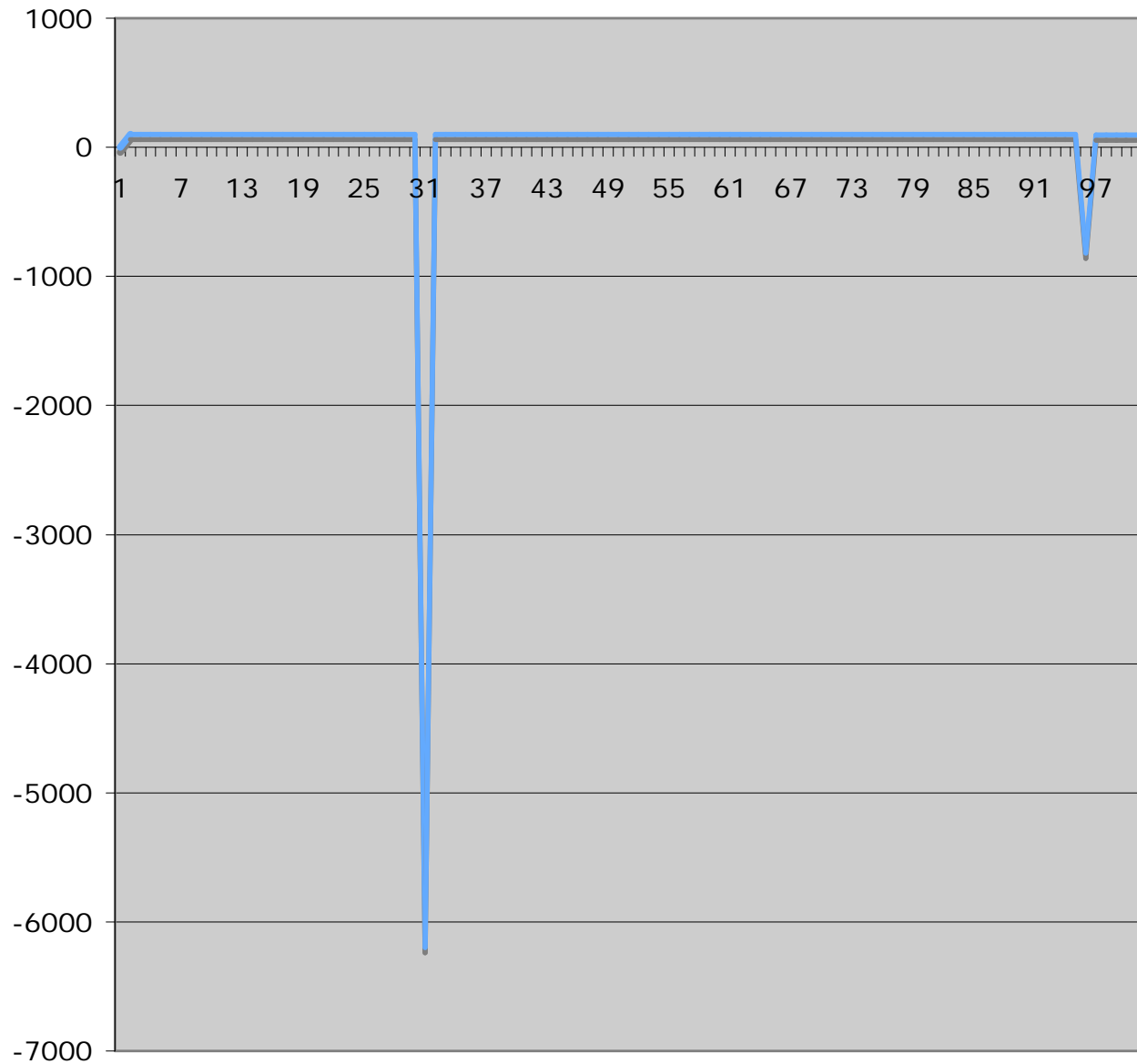**#10 Can Capture Procompetitive Aspects of Bundling without Exclusion**

You are free to accept these propositions individually. They are not bundled

#1 Hard to Justify Negative Prices

We see negative prices as a result of discounts that go back to unit one.

Issue arises both with single product and multi-product rebates

Price of Incremental Unit

Customer will always buy at least 31 units.

If customer gets up to 85 units, then will go up to 95 units.

Rival may sell 1--4 units or 16 to 69 units.

Rival will be excluded if buyer doesn't want to split market 50:50 and below 5% is too small to consider.

One solution is to have discounts be on incremental volume.

Not anti-consumer. Discounts can be bigger.

#2 Loyalty Discounts Can Create No-Cost Predation

The way it works is that price of A is inflated if you don't buy B.

Normal monopoly price of A is 100
Get A at 100 if also buy B at 20

But if don't buy my B, then have to pay 120 for A.
Thus effective cost of B is zero (or below cost).

Point is that no one actually pays 120. This is a threat that, if credible, need not be employed.

Unlike regular predation, where firm actually has to sell product at below cost, here incumbent only has to offer discount from unused a la carte price of A

Since it is less costly to employ (no recoupment required), greater risk to competition and no benefit to consumers along the way